DOCKET FILE COPY ORIGINAL

Before the

FEDERAL COMMUNICATIONS COMMISSION

Washington, D.C. 20054

In the Matter of	)	
	)	CC Docket No. 96-45
Federal-State Joint Board on	)	
Universal Service	)	

COMMENTS OF
MFS COMMUNICATIONS COMPANY, INC.

Andrew D. Lipman
Mark Sievers

SWIDLER & BERLIN, CHARTERED
3000 K Street, N.W., Suite 300
Washington, D.C. 20007
(202) 424-7500

Attorneys for
MFS COMMUNICATIONS
COMPANY, INC.

Dated: April 12, 1996

COMMENTS OF
MFS COMMUNICATIONS COMPANY, INC.

Table of Contents

SUMMARY

As a long time proponent of universal service reform, MFS enthusiastically supports the Commission and Joint-Board's efforts to resolve the issues that stymie competition under the guise of "universal service." As the Commission and Joint-Board develop the Nation's universal service policies, such policies should recognize:

1. Competition preserves and advances universal service so universal service subsidies should be provided only in extraordinary circumstances;
2. Universal service support should not be used to guarantee an incumbent's revenues or earnings and should not be based on an incumbent's costs or revenue requirements;
3. Universal service support, if any, should be explicit, specific, predictable and sufficient and administered by an independent entity; and.
4. Universal service support should be narrowly targeted to individuals who could not afford telephone services without assistance, competitively neutral and portable.

The Commission and Joint-Board should retain the universal service support mechanisms that are targeted to individuals, specifically Lifeline, Link Up and TRS support. High-cost support mechanisms (USF, DEM weighing and LTS) should be replaced with a high-cost support mechanism that is based on the forward-looking costs of an efficient competitor at a level of disaggregation, like census blocks, much smaller than the state study areas used today. High-cost support should be no larger than is presently provided. As a starting point, support should be limited to areas with with costs greater than 130% of the national average and household incomes less than 130% of the national average.

The Telecommunications Act requires that the Commission establish discounted access to the services comprising universal service for schools and libraries. However, discounting the price of basic local telephone service will likely have little impact on schools' and libraries' use

of the Internet since the price of telecommunications is small relative to the cost of computer hardware and software used for Internet access. The Commission can best encourage deployment of advanced telecommunications services to schools, libraries and health care providers by encouraging the development of local telephone competition.

The recovery of NTS costs results in a mismatch between CCL revenues and loop costs that historically yielded a windfall for incumbent local exchange carriers that is not targeted to low income consumers and high-cost areas. Preserving the windfall is not essential to the promotion, preservation or maintenance of universal service. The Commission should eliminate the CCL and, as necessary, transfer recovery of NTS costs to end-user customers.

The Commission should exempt carriers with less than a 1% market share from providing universal service support, and should require only common carriers to contribute to universal service support. Contributions to universal service support should be based on telecommunications carriers' common carrier revenues less payments to intermediaries. The universal service fund should be administered by an independent non-governmental agency that has no competitive interest in who receives or who provides universal service support.

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20054

In the Matter of	)	
	)	CC Docket No. 96-45
Federal-State Joint Board on	)	
Universal Service	)	

COMMENTS OF MFS COMMUNICATIONS COMPANY, INC.

MFS Communications Company, Inc. ("MFS"), by its undersigned counsel and pursuant to Section 1.415 of the Commission's rules, submits these comments in response to the Commission's Notice of Proposed Rulemaking and Order Establishing a Joint Board in the above captioned proceeding.

INTRODUCTION

MFS enthusiastically supports the Commission and Joint-Board's efforts to address and resolve many of the issues that stymie competition under the guise of "universal service." MFS is a long-time proponent of reform of universal service support mechanisms. In 1993, MFS filed a *Petition for Notice of Inquiry and En Banc Hearing*[1] with the Commission that advocated many of the universal service reform principles embodied in the Telecommunications Act of 1996[2] and this rulemaking. Since many of the principles are unchanged, MFS offers Attachment 1 to these comments as a concise statement of the universal service policy

---

1 In the Matter of Inquiry into Policies and Programs to Assure Universal Telephone Service in a Competitive Market Environment, RM8388 (Nov. 1, 1993).

2 Telecommunications Act of 1996, Pub. L. 104-104, 110 Stat. 56 (1996).

principles MFS continues to support. Attachment 1 is the same attachment MFS filed with its universal service petition in 1993.

In this filing, MFS follows the general outline of the Notice in offering its comments on the various issues raised in the above captioned rulemaking.

I. GOALS AND PRINCIPLES OF UNIVERSAL SERVICE SUPPORT MECHANISMS

The Telecommunications Act directs the Commission and the Federal-State Joint Board ("Joint Board") to recommend changes to any of the Commission's regulations based on "policies for the preservation and advancement of universal service."[3] As the Commission and the Joint-Board develop the Nation's universal service policies, such policies should recognize:

1. Competition preserves and advances universal service so universal service subsidies should be provided only in extraordinary circumstances;
2. Universal service support should not be used to guarantee an incumbent's revenues or earnings and should not be based on an incumbent's costs or revenue requirements;
3. Universal service support, if any, should be explicit, specific, predictable and sufficient and administered by an independent entity; and,
4. Universal service support should be narrowly targeted to individuals who could not afford telephone services without assistance, competitively neutral and portable.

A. Competition Preserves and Advances Universal Service so Subsidies Should be Provided only in Extraordinary Circumstances

As the Commission and Joint Board develop universal service policies, they should presume that opening markets to competition will preserve and advance universal service and

---

3 47 U.S.C. §254(a)(1).

implement universal service subsidies only in extraordinary circumstances. Historically, as competition came to various telecommunications markets, opponents of such competition raised the spectre of a threat to universal service to stymie opening "their" markets to competition. However, in spite of incumbent firms' dire predictions, competition in telecommunications markets has never proven to be harmful to universal service. Telephone subscribership is at historic high levels and U.S. subscribership is far higher than in countries where telecommunications services are provided in a non-competitive market structure. Clearly, the telecommunications market is unambiguously more competitive today than it was 20 years ago, and the U.S. telecommunications market is far more competitive than the majority of foreign markets.[4] In its recent survey of universal service support mechanisms, the Commission Staff summarized the role of competition in promoting universal service.

> New entrants in local telecommunications markets have strong incentives to develop and implement cost-efficient technology, creating pressure for the incumbent service provider to lower prices and improve service capabilities. Effective local service competition thus can promote universal service by stimulating technological advancement, lower prices, and marketing innovation. The Commission has already observed that prices are lower in cable television markets subject to competition and expects the entry of competitive access providers to lead to lower access prices in telephone markets.[5]

As the Commission and the Joint Board develop universal service policies, they should not fall victim to the Cassandras who claim that competition threatens universal service. In fact, competition promotes universal service for several reasons.

---

4 In fact, countries with very low telephone penetration, like Mexico, Brazil, and other Latin American countries, are opening their telecommunications markets to competition. Such actions would be irrational if competition actually threatened universal service. One explanation is that competition stimulates investment in telecommunications infrastructure, attracts new entrants and stimulates demand for telecommunications services.

5 Common Carrier Bureau, *Preparing for Addressing Universal Service Issues: A Review of Current Interstate Support Mechanisms*, pg. 26 (Feb. 23, 1996) ("Universal Service Survey") [emphasis added, footnotes omitted].

1. Competition reduces prices and increases the value of telephone service.

Competition in many telecommunications markets has proven to provide powerful incentives to reduce prices, which stimulate demand for service. Likewise, competition encourages firms to be more responsive to customers' demands and to develop new products or services that enhance the value of telecommunications services and stimulate demand.[6] It is economically irrational for providers in an effectively competitive market to raise prices to unaffordable levels, degrade service quality or otherwise drive customers off their networks.

2. Competition has not harmed incumbent providers.

There are many examples of how competition has benefited incumbents rather than harmed them. At divestiture, AT&T served nearly all of the long distance marketplace. More than a decade later, AT&T has lost more than 30% of its market share and reduced its prices more than 40%, yet its revenues and earnings today are higher than they were at divestiture. Competition created incentives for AT&T to streamline its operations, reduce its costs, become more responsive to customers, and stimulate the market with a variety of new services and promotions. It is reasonable to believe that incumbent local exchange carriers will respond to competition in exactly the same way. Just as no subsidies were required to assure the universal availability and affordability of long distance services in a competitive market, subsidies should not be required in a competitive local telephone market.

---

6 When proposing to offer competitive local exchange services, even incumbent local telephone companies agree that competition stimulates universal service. For example, in testimony filed with the Maryland Public Service Commission, Michael Gilliam, the President of SBC Media Ventures, a wholly owned subsidiary of SBC, stated flatly that "SBC-MV believes that competition can enhance universal service. Competition generally reduces prices and makes telephone service more affordable." *In the Matter of the Investigation by the Commission on its Own Motion into Legal and Policy Matters Relevant to the Regulation of Firms, Including Current Telecommunications Providers and Cable Television Firms, which may Provide Local Exchange and Exchange Access Services in Maryland in the Future*, Case No. 8587, Direct Testimony of Michael Gilliam on Behalf of SBC Media Ventures, Inc. pg. 11 (June 10, 1994)

While they have not been subject to the same competitive intensity as AT&T, the largest incumbent local exchange carriers are financially better off today than they were a decade ago in spite of the introduction of competition in "their" markets. Since 1987, the Commission's reports indicate that state regulators, often as a reaction to overearnings by incumbent local exchange carriers, have reduced incumbent local exchange carrier annual revenue requirements by about $5.1 billion.[7] These multi-billion dollar regulator-mandated revenue reductions are stark evidence that competition has not harmed incumbent local telephone companies nor has it threatened universal service. In fact, at a recent investment conference, NYNEX's chief executive, Ivan Seidenberg predicted that NYNEX's revenues would double from $13.7 billion in 1995 to between $25 and $27 billion by 2003-2005 in spite of a predicted market share loss of 30-35% over the next five to seven years. Seidenberg told investors "What is lost to competitors is made up for in new growth."[8]

In short, as the Commission and the Joint-Board develop universal service policies they should not view competition as a universal service problem to fixed, but rather, as an ally in the preservation and advancement of universal service.

3. ***The "myth" that local rates must be subsidized is not true.***

A common "myth" of the telephone industry is that local telephone service is priced below costs, and that such below cost pricing is necessary to ensure that consumers will subscribe to telephone service. The "myth" concludes that local telephone companies need to preserve subsidies in order to preserve below cost local telephone service, which is threatened by competitors who drive out internal cross-subsidies by targeting high-margin, subsidy

---

7 Industry Analysis Division, Common Carrier Bureau, Summary of State Telephone Rate Cases (March 1996). The reported figure is total revenue reductions ($5.3 billion) minus total revenue increases ($202 million) ordered by state commissions

8 *NYNEX expects to double revenues by 2003-2005*, THE MORNING REPORT (March 28, 1996) MFS newsclipping service drawn from Reuters News Services.

generating market segments. Local telephone company revenues are often described like a balloon -- if competition squeezes the revenue balloon at one end, the local ratepayer end of the balloon must expand to recoup the losses. The myth is utterly untrue and perpetuated by incumbent firms that seek government protection to restrict competition in the markets they dominate. The Commission and Joint-Board should be aware of the myriad of fundamental flaws in this "myth."

Local telephone costs will be lower in a competitive marketplace. Universal service support programs should not be based on incumbent carriers' revenue requirements or costs, but rather, should look to the costs of an efficient, market-driven competitive provider. In an effectively competitive local exchange market, firms have powerful economic incentives to reduce their costs and become more efficient. No one knows what it really costs to provide local telephone service in a competitive market because there has never been effective local telephone competition to create the economic incentives for incumbent telephone companies to reduce costs and improve efficiency. In a competitive environment, the prices that incumbent carriers assert are below cost and need to be subsidized may well prove to be profitable.

Individual service prices in a competitive marketplace providing bundled services may be below cost. In a competitive marketplace, it may be economically sensible to offer services below cost in two instances: (1) when a firm adds telephone service to an existing product line; and, (2) in order to have the opportunity to sell more profitable services to customers. As the Commission Staff described in its Universal Service Survey, new entrants may be adding local telephone service to cable television service, electric utility service, or adjoining local exchange services.[9] In such circumstances, adding local telephone service may cost far less than the stand-alone costs of incumbent local telephone company. Since

---

9 Universal Service Survey at pp. 28-29.

competition will drive costs to the level of the most efficient provider, universal service funding should be based on the lower of the costs irrespective of the incumbent's embedded stand-alone costs.

Also, a vertically integrated firm may offer local telephone service at or below cost for the opportunity to market and bundle long distance services, vertical services, information services, video services, and/or telephone equipment with the "subsidized" local telephone service. In the competitive wireless industry, for example, cellular providers often give away or sell for a nominal amount cellular phones costing hundreds of dollars in order to have the opportunity to market other telecommunications services to customers. In an interview in *Wired*, Bell Atlantic's chief executive officer, Raymond Smith applied this same pricing principle to telephone service when he predicted, "I can envision one day offering various packages of services. And one of them might be a package of video and interactive services in which the customer also gets phone service for another two or three bucks."[10] Obviously, it is not sensible public policy to develop universal service support programs to subsidize such market-driven below cost offerings.

B. Universal Service Support Should Not be Used to Guarantee Incumbent Firm Revenues and Should Not be Based on Incumbent Firm Costs

Universal service should not be a mechanism to preserve incumbent local exchange carrier revenues or earnings. Plainly, the legislative intent of the Telecommunications Act is "to provide for a pro-competitive, de-regulatory national policy ... opening all telecommunications markets to competition."[11] In a competitive environment, a firm's revenues and earnings

---

10 D. Kline, *Align and Conquer*, 3.02 WIRED 100, 164 (Feb. 1995).

11 Telecommunications Act, Conference Report, p. 1.

depend entirely on its entreprenuerial efforts. A competitive firm's revenues and earnings are not guaranteed by payments from competitors. In the television industry, for example, Zenith has no right to receive payments from Sony to recoup competitive losses, guarantee Zenith's revenues or maintain a particular return. Universal service funding designed to maintain incumbent local exchange carrier revenues or earnings is utterly contrary to the pro-competitive intent of the Telecommunications Act and should be rejected.

Universal service support should also be independent of the incumbent firm's costs and revenues. As the Commission has discussed in prior universal service inquiries, support mechanisms, such as the Universal Service Fund ("USF"), that are based on the incumbent firm's revenue requirements distort incentives for incumbents to reduce their costs and become more efficient.[12] As noted above, in a competitive environment, firms have incentives to reduce costs, so the incumbent's costs arguably provide no information about the costs of providing service in a competitive market. Also, the incumbent's costs are based on a particular technology, which may not be the technology used by competitors in a competitive environment. <u>To the extent that universal service support is required, it should be based on an independent estimate of the incremental costs to provide service to specific areas.</u> Said differently, universal service support should be based on the additional costs that an efficient competitor using a forwarding-looking technology would incur by adding local telephone service to its product line, and not based on the embedded costs or embedded technologies of incumbent service providers.

For example, the Hatfield study which was commissioned by MCI to develop estimates of the costs of local telephone service found that wireless technologies can provide service at

---

12 *In the Matter of Amendment of Part 36 of the Commission's Rule and Establishment of a Joint-Board*, CC Docket 80-286, Notice of Inquiry, 9 FCC Rcd 7404 at ¶ 12 (released Aug. 30, 1994) and Notice of Proposed Rulemaking and Notice of Inquiry, 10 FCC Rcd 12309 at ¶¶ 55-63 (released July 13, 1995).

costs that are $25 a month lower than wireline technologies in areas with very low population density, which tend to be considered high cost areas.[13] Likewise, in a competitive local service environment, cable television companies, electric utility companies and satellite technologies may provide lower cost alternatives that the traditional wireline services provided by incumbent local exchange carriers.

C. Universal Service Support Must Be Explicit, Specific, Predictable and Sufficient and Administered by an Independent Entity

Universal service support should be explicit and well defined rather than buried in a Byzantine system of cross-subsidies that distort markets, hide costs and paralyze policy makers for fear that any action threatens universal service. Today's universal service support system is a giant "fuzzball" that hides costs, distorts competition, and yields economically irrational prices. The Telecommunications Act requires that any universal service support be explicit,[14] "specific, predictable and sufficient"[15] and collected from every interstate telecommunications carrier on an "equitable and nondiscriminatory basis."[16] The conference committee report clearly indicates that Congress intended that any universal service support be explict.

> To the extent possible, the conferees intend that any support mechanisms continued or created under new section 254 should be explicit, rather than implicit as many support mechanisms are today.[17]

The Commission and Joint-Board should develop universal service policies that put an end to ill-defined universal service support mechanisms. Universal service support should be explicit

---

13 Universal Service Survey at pp. 29-30.

14 47 U.S.C. §254(e). "Any such support should be explicit and sufficient to achieve the purposes of this section."

15 47 U.S.C. §254(d).

16 *Id.*

17 Joint Explanatory Statement of the Commitee of Conference, p. 131.

in that it should consist of payments that are used only for the provision of services comprising universal service. Subsidies, if required at all, must be made explicit so that regulators can monitor them and ensure that they are appropriately assessed and distributed.

It is widely recognized that many telecommunications prices contain substantial levels of contribution that incumbent local exchange carriers often claim is necessary for the support of universal service.[18] The Commission's Notice and the Staff's Universal Service Survey cataloged a variety of implicit and explicit suppport mechanisms, including:

- ***High Cost Support***, including the Universal Service Fund ("USF") and Dial Equipment Minute ("DEM") weighting for smaller carriers in high-cost service areas,[19]
- ***Low Income Support***, including Lifeline and Link Up programs,[20]
- ***Local Loop Support***, including recovery of the interstate allocation of loop costs through a combination of subscriber line charges ("SLCs") paid by end-users and carrier common line ("CCL") charges paid by long distance carriers;[21]
- ***Long Term Support*** ("LTS") paid by larger local exchange carriers;[22]
- ***Rural Telephone Company Support*** comprised of subsidized loan programs;[23]
- ***Telecommunications Relay Service ("TRS") Support*** for hearing impaired telecommunications users;[24]

---

18 A review of telecommunications subsidy studies is in C. Weinhaus, *et al.*, *Apples and Oranges: Differences between Various Subsidy Studies*, Telecommunications Industry Analysis Project (July 19, 1995).

19 Notice at ¶¶ 14, 40-45.

20 Notice at ¶¶ 61-65.

21 Notice at ¶¶ 112-114.

22 Notice at ¶ 115.

23 Universal Service Survey at pp. 78-89.

24 Universal Service Survey at pp. 45-49.

- ***Geographically Averaged Rates*** creating an implicit subsidy from low-cost areas to high-cost areas.[25]

- ***Transport Rate Structure Support*** including the residual interconnection charge ("RIC") associated with the restructure of local transport charges, which is a subsidy (but, obviously, the RIC is not intended to support local service) since it is a charge that has no basis in costs or the marketplace but is merely intended to maintain incumbent local exchange carriers' pre-restructure transport revenues;[26]

In addition to the subsidies identified by the Commission and the Staff,

- ***USTA Subsidy***. In a widely circulated study, USTA argued that the contribution or subsidies in telecommunications prices at risk of loss to competition amount to $20 billion annually and represented the subsidy to be the difference between prices and marginal costs.[27]

- ***Interstate/Intrastate Differences and Differences Between Carriers***. There is often a substantial difference between incumbent local exchange carriers' interstate and intrastate rates for identical services using identical facilities in exactly the same manner (*e.g.*, the difference between interstate and intrastate access charges) and substantial differences in rates among incumbent local exchange carriers for services that use substantially similar facilities and technologies to serve the demands of substantially similar populations (*e.g.*, the difference between BellSouth's access charges and GTE's access charges in Florida). These price differentials are simply not cost based or

---

25 Universal Service Survey at pp. 100-106. An estimate of the aggregate subsidies associated with geographic averaging is presented in C. Weinhaus, *What is the Price of Universal Service? Impact of Deaveraging Nationwide Urban/Rural Rates*, Telecommunications Industry Analysis Project (July 26, 1993).

26 Universal Service Survey at pp. 111-124.

27 C. Monson & J. Rohlfs, *The $20 Billion Impact of Local Competition in Telecommunications*, Strategic Policy Research (July 16, 1993).

market driven, but can be variously characterized as monopoly rents, by-products of jurisdictional separations, or contribution.

Are all these mechanisms universal service subsidies? Certainly, they result in prices and charges that would not persist in a competitive environment and have no basis in economic costs, but with the exception of the programs targeted to end-users (Lifeline, Linkup, TRS) and rural telephone companies (Rural Telephone Loans) there is absolutely no evidence that these mechanisms are explicitly linked to the preservation of universal service. Instead, they amount to a giant corporate welfare program benefiting some of the world's largest most profitable corporations. Many of the subsidy programs described above are not explicit nor are they targeted to supporting universal service, but rather, focus on preserving incumbent local exchange carrier revenues. In establishing an explicit universal service support mechanism, the Commission and the Joint-Board has an opportunity to greatly clarify the structure of universal service support. It should establish an explicit universal service support mechanism and eliminate the complex structure of subsidies described above.

Universal service support, if required, should be administered by an independent entity. Experience with the universal service "fuzzball" clearly demonstrates that universal service support mechanisms that are administered by the beneficiaries (*e.g.*, the USF, LTS and the host of internal cross-subsidies described above and maintained by incumbents) cannot be explicitly known, completly objective or competitively neutral. If the Commission and the Joint-Board establish a universal service funding mechanism, it should be administered by an independent entity that has no competitive interest in who receives or who provides universal service support.

D. Universal Service Support Must be Targeted, Competitively Neutral, and Portable Among Competitors

As the Commission and Joint-Board develop universal service policies they should refrain from implementing programs designed to generate broad untargeted subsidies. Universal service support, if any, should be narrowly targeted to the end-users who, without extraordinary assistance, could not afford service in a competitive market. Not everyone and every area in the United States needs to receive subsidized telephone service; universal service support should be the exception and not the rule.

As described in the Staff's Universal Service Survey, the gains in telephone subscribership have leveled off in the last decade and the majority of persons without telephone service once were subscribers who dropped off the network because of an inability to pay toll charges.[28] Thus, arguably the "fuzzball" of untargeted subsidies no longer contributes to the advancement of universal service.

Universal service support should be targeted to customers, and not to telephone companies. In developing universal service policies, it may be appropriate to target low income customers who, without assistance, would be unable to afford telephone service. Lifeline, Link Up and TRS programs are obvious examples of support targeted to end-users. It may also be appropriate to target customers who live in unusually high cost service areas, where, without assistance, telephone service would be unaffordable. Rather than provide universal service support to telephone companies to support operations, costs and facilities that may have no relationship with universal service, universal service support should follow customers who can effectively direct it to whomever provides supported service to them.

---

28 Universal Service Survey at pg. 17. Also see M. Mueller & J. Reina Schement, Rutgers University Project on Information Policy, *Universal Service from the Bottom Up: A Profile of Telecommunications Access in Camden, New Jersey* (1995).

As the Commission Staff described in its Universal Service Survey, since households who drop off the network do so for an inability to control toll charges, targeted support need not take the form of financial assistance for local telephone service. Rather, as described in the Commission Staff's Universal Service Survey, the Commission and the Joint-Board should consider targeted assistance to include options such as limitations on disconnection of local service for failure of low-income households to pay toll services, low cost toll blocking services, self-certification by households of their eligibility for Lifeline and Link Up assistance, and "quick dial tone" access to 911 emergency services.[29]

Throughout the Notice, the Commission solicited comments on the degree to which universal service support should be competitively neutral.[30] Because of the overarching pro-competition goals of the Telecommunications Act and specific language in the Act, universal service support should be competitively neutral in two respects:

- Firms that <u>receive</u> universal service support should not be placed at a competitive advantage over competitors who do not receive universal service support.
- Firms that <u>provide</u> universal service support, either in-kind or monetary payments, should not be placed at a competitive disadvantage by virtue of providing such support.

Congress' intent that receipt of universal service support be competitively neutral is evident in the language of Section 254(k) of the Telecommunications Act, which expressly prohibits subsidies from non-competitive services to competitive services.

> <u>A telecommunications carrier may not use the services that are not competitive to subsidize services that are subject to competition</u>. The Commission, with respect to interstate services, and the States, with respect to intrastate services, shall establish necessary guidelines to ensure that services included in the

---

29 Universal Service Survey at pp. 19-21. Also see NTIA Comments in In the Matter of Amendment of the Commission's Rules and Regulations to Increase Subscribership

30 Notice at ¶¶ 8, 17.

definition of universal service shall bear no more than a reasonable share of the joint and common costs of facilities used to provide those services.[31]

Similarly, Section 254(e) requires that recipients of universal service support use it only for the services for which the support is intended,[32] and Section 254(h)(2) requires that "the Commission shall establish competitively neutral rules" for the provision of advanced telecommunication services to schools and libraries.[33] Congress' intent that the provision of universal service support be competitively neutral is evidenced by the principles of universal service which require that "all providers of telecommunications services" should contribute to universal service,[34] and the requirements of Section 254(d) that "[e]very telecommunications provider that provides interstate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, to the specific, predictable, and sufficient mechanisms established by the Commission to preserve and advance universal service."[35]

The best way to ensure that universal service support received is competitively neutral is to provide such support to low income or high-cost customers as a credit that can be applied to whatever telecommunications service provider the customer chooses. Said differently, a system of customer credits should be entirely portable among service providers and whomever provides service to a supported low-income or high-cost customer would be entitled to receive universal service support. Both Lifeline and Link Up are programs that could be easily portable among competitors, but there is no portable support among high-cost customers.

---

31 47 U.S.C. §254(k). [emphasis added]

32 47 U.S.C. §254(e). "A carrier that receives such support shall use that support only for the provision, maintenance, and upgrading of facilities and services for which the support is intended."

33 47 U.S.C. §254(h)(2).

34 47 U.S.C. §254(b)(4).

35 47 U.S.C. §254(d).

To ensure that universal service support is competitively neutral among those who contribute to universal service funding, the Commission and Joint-Board should develop funding mechanisms that spread the burden of universal service funding among all telecommunications service providers. The best way to equitably spread the burden is to apportion responsibility for funding based on each firm's respective revenues net of payments to intermediaries. Thus, a long distance carrier's share of the universal service funding would be based on its revenues less access payments to local exchange carriers. A local telephone company's share of universal service funding would be based on its revenues less payments to other local exchange carriers for interconnection, compensation and unbundled network elements.

II. SUPPORT FOR RURAL, INSULAR, AND HIGH-COST AREAS AND LOW-INCOME CONSUMERS

A. Only Basic Local Telephone Service in High-Cost Areas or Provided to Low Income Customers Should be Included Among Potentially Subsidized Services

In its Notice, the Commission seeks comments on the scope of services that should be included in the basket of services considered part of universal service and thus, eligible for a universal service subsidy.[36] Only basic local telephone services should be considered a component of universal service and eligible for universal service subsidies. The core services listed by the Commission in its Notice are a reasonable collection of services that should be considered part of universal service.[37] Any authorized carrier that provides this core collection of services, either using a switching platform it owns (or substantially controls) and employing

---

36 Notice at ¶¶ 16-23.

37 Notice at ¶ 16. The core services include: (1) voice grade access to the public switched network with the ability to place and receive calls; (2) touch-tone service; (3) single party service; (4) access to emergency services (911); and, (5) access to operator services.

number resources assigned to it as a local exchange carrier should be considered an eligible carrier under the provisions of Section 214(e). The Telecommunications Act is intended to be pro-competitive, deregulatory in nature. Since competitive markets are not characterized by subsidized offerings, extending subsidies to more than just a basic collection of services would fly in the face of this pro-competitive legislative intent.

A market cannot be considered competitive if everyone and every area in that market receives a subsidy. Thus, it would be contrary to the pro-competitive deregulatory intent of the Telecommunications Act if universal service subsidies were developed for every consumer in every market. Rather, basic local telephone services should be subsidized only for low income consumers and consumers in high-cost service areas where, without extraordinary assistance, service would be unaffordable. As the Commission Staff noted in its Universal Service Survey, existing programs that target assistance to low income households are widely deployed in the United States. Thirty-six states participate in the Lifeline program (which waives all or a portion of the $3.50 subscriber line charge) and Link Up (which pays half of the first $60 of connection charges) is available in all but two states.[38] The costs of such targeted assistance are modest -- in 1994, 4.4 million households took advantage of Lifeline assistance at a total cost of $123 million and 840,000 households received $19 million of Link Up assistance.

B. Determining the Size of the Universal Service Fund

The Commission seeks comments on how to determine the size of any universal service subsidies, and how to assess standards such as "affordable" and "reasonably comparable" for

[38] Universal Service Survey at pp. 34-35.

rural, insular and low income customers.[39] Determining the size of a universal service fund requires that the Commission and Joint-Board identify the areas and individuals that ought to be subsidized and fix the amount of subsidy to be provided to such areas and individuals.

The proxy cost model described by the Commission in its Notice[40] provides a carrier-independent mechanism for identifying the total costs of providing local residential service at a census block level.[41] Those costs can be used to identify the nation's high-cost service areas. Because they are developed using census block data, the results of the proxy cost model can also be matched to household incomes, so that services provided to consumers in wealthy areas like Jackson Hole, Wyoming or Bar Harbor, Maine are not unnecessarily subsidized. Obviously, the Commission and the Joint-Board will have to set cost and income thresholds, which is fundamentally a subjective judgment. MFS suggests as a starting point that the Commission classify census blocks as high cost areas when such areas have per line costs greater than 130% of the national average, and restrict subsidies to census blocks where the average household income is greater than 130% of the national average.

For high-cost census blocks that are not also high-income areas, the universal service subsidy can be simply the difference between the per line proxy costs and 130% of the national per line average proxy costs. Any eligible carrier under the provisions of Section 214(e) that provides service to such high-cost census blocks would be eligible to receive the subsidy on a per line basis. Such a mechanism would be simple to administer and portable among competitors since the subsidies would track whomever a customer selected to be her service

---

39 Notice at ¶¶ 25-39.

40 Notice at ¶¶ 31-34.

41 The proxy cost model does not provide an estimate of the costs to provide the bundle of core services the Commission proposes to include in universal service. Thus, if it is used, the proxy cost model would have to be modified to include such costs.

provider. It would also be explicit, predictable, sufficient, targeted, and replace the existing untargeted high-cost support mechanisms, including USF, DEM weighting and LTS. Because support would be based on census blocks, which are only about 400 households, as a practical matter, carriers would serve everyone in the census block rather than target only the most lucrative customers.

High-cost universal service support should be capped at the existing high-cost support levels. In 1996 USF is estimated to generate $734.6 million, DEM weighting is estimated to generate about $311 million.[42] There is no reason to expect that support for high-cost areas will exceed this level in a competitive market since that level of support has been adequate to advance universal service in a monopoly environment. Thus, a proxy cost model should be used to determine the size of the high-cost support fund subject to the aggregate cap. If the proxy cost model is larger than the cap, then it should be used to apportion high-cost support funds among firms that serve high-cost areas.

Such a universal service funding mechanism would be in addition to existing programs aimed to providing subsidized service to low income customers, namely Lifeline and Link Up. There is no compelling reason to modify these existing programs as they already provide a mechanism that targets support to low income individuals.

Regulating the level of local service rates should continue to be the responsibility of state regulators who have historically ensured that local rates are "affordable." Because "affordability" can vary from location to location, the Commission and the Joint-Board should not become mired in trying to determine a national standard for "affordable" local service prices.[43] If universal service support is based solely on the difference between proxy costs and 130% of

---

42 Universal Service Survey at pp. 53, 66 (1995 estimate for DEM weighting).

43 Notice at ¶¶ 25-26

the national average costs, there is no need to wrestle with what constitutes "affordable" local service rates.

III. SCHOOLS, LIBRARIES, AND HEALTH CARE PROVIDERS

The Telecommunications Act requires that the Commission develop distinct funding mechanisms for schools, libraries and rural health care providers. Under the Telecommunications Act, schools and libraries are to be provided access to the bundle of services included in the universal service definition at "rates less than the amounts charged for similar services to other parties."[44] The discount shall be determined by the Commission for interstate services and States for intrastate services that is necessary to "ensure affordable access to and use of such services" by schools and libraries. In addition, the Commission is directed to establish "competitively neutral rules" to enhance access to advanced telecommunications services for all public and non-profit elementary and secondary school classrooms, health care providers and libraries.[45]

It is important to note that the development of a discount for schools and libraries extends only to the package of services included in universal service. Thus, given the limited package of services that the Commission proposes to include in universal service, and given the prices of local telephone service, it is not clear that schools and libraries do not already have affordable access to and use of universal service functionalities.

Certainly, there are many schools and libraries that wish to enhance their ability to use telecommunications technologies. For example, Internet connections in every classroom might be desireable. However, discounting the price of dial-up service included in universal service

---

44 47 U.S.C. §254(h)(1)(B).

45 47 U.S.C. §254(h)(2)

will not likely make much impact on schools' use of the Internet as the price of computer hardware and software are large relative to phone costs. A $25 local line and a $20 monthly subscription fee to an Internet service provider are swamped by the $3,000 that might be required to buy a computer with a modem and appropriate software to access the Internet. Realistically, discounting the $25 local line will likely have no impact on whether schools can afford to access and use the Internet.

The Commission can promote access to advanced telecommunications service simply by promoting local telephone competition. As competition develops, new firms will want to serve schools, libraries and health care providers. For example, in the competitive personal computer market, manufacturers like Zenith and Apple have historically provided discounts for computers purchased by students and faculty. Such discount programs were often premised on the notion that students and faculty would continue to purchase Zenith and Apple products after graduation. Similar incentives may encourage competitive local service providers to provide service at a discount in order to give future consumers a "taste" of their services.

IV. OTHER UNIVERSAL SERVICE SUPPORT MECHANISMS

The Commission seeks comment on whether to change the existing mechanisms for recovering non-traffic sensitive ("NTS") loop costs through a combination of usage sensitive CCL charges and flat-rate SLCs paid by end-users.[46] Generally speaking, because long distance traffic grows faster than local loops, usage sensitive CCL charges generate revenues faster than loop costs resulting in a windfall for incumbent local exchance carriers. The

---

[46] Notice at ¶¶ 112-115.